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C O N F I D E N T I A L SECTION 01 OF 02 SANAA 002521

SIPDIS

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TAGS: [ECON](#) [KMCA](#) [KMPI](#) [PGOV](#) [YM](#) [ECON](#) [COM](#) [DOMESTIC](#) [POLITICS](#)

SUBJECT: WHY ECONOMIC REFORM IS FAILING IN YEMEN

REF: A. SANAA 1721

[B](#). SANAA 1537

[C](#). SANAA 122

Classified By: DCM Nabeel Khoury for reasons 1.5 (b) and (d).

[1](#)1. (C) Summary and Comment: On September 25 Parliament and the Shura Council voted by a clear majority to reject the ROYG's five year economic plan, which included several hotly debated economic reform proposals. The economic package failed because there was no presidential initiative, no strategy to offset the economic consequences of reforms, and parliament's ongoing frustrations over executive branch corruption. At the same time, the UK's Department For International Development (DFID) released initial results of a study on the impact of reducing oil subsidies and found, contrary to ROYG claims, that the effects on the poorest Yemenis would be minimal. After a summer of blackouts and a long military campaign in the north, the Parliament's reversal of a corrupt government oil deal, and a rumored cabinet shuffle may signal a new focus on reform. Until Saleh commits to reducing corruption, however, and presents a comprehensive plan that faces harsh economic realities, cabinet shuffles and reform initiatives will do little to help the average Yemeni. End Summary and Comment.

Economic Reform Proposals Flatly Rejected

[1](#)2. (C) On September 22, the first day of a two-day joint Shura Council and Parliament session to discuss the Government's five-year plan, Prime Minister Ba Jammal was ushered out of the building as body guards of MPs shouted angry slogans at the unpopular prime minister. Local press reported that the group shouted "Down with Ba Jammal," "Down with Salami" and "Oh Parliament, Oh Shura, Ba Jammal is the biggest swindler." Returning to the joint session on September 25, Ba Jammal and his ministers attempted to explain the benefits of the reform package. Members responded with harsh criticisms of government corruption, unemployment, and the state of the economy.

[1](#)3. (C) Background: The economic reform plan (refs A and C) would have reduced diesel subsidies, rolled back customs fees, implemented a new General Investment Law, established a General Sales Tax, and streamlined the civil service. The IMF, World Bank and most donors strongly encouraged the ROYG's adoption of the reforms. In an attempt to provide political cover, the Cabinet asked Parliament to vote on the package in January. Since February, however, Parliament, emboldened by their dominant speaker Sheikh al-Ahmar's absence from the country for medical treatment, has been asserting its role vis-a-vis the Executive on economic issues. The Executive, on the other hand, has failed to make a convincing case for reform. End Background.

No Push from the Top

[1](#)4. (C) While economic reform was one of the most actively debated issues in the press and at qat chews over the past year, President Saleh made few public statements supporting the reforms, and never argued publicly to cut the diesel subsidy. In talks with senior USG officials, Saleh often predicted "revolution in the streets" if the oil subsidies were reduced. Former Member of Parliament Saad bin Talib commented to Emboffs that there was no push from the President for passage of the economic reform package. Shura Council Member and former Minister of Labor Mohammed al-Tayyeb described a disorganized GPC effort, with only a few loyalists supporting the reforms. Some observers commented that the ROYG miscalculated in its attempt to gain Parliamentary approval for the economic reform package. Talib said he was "shocked" that the economic reforms did not pass, commenting that previously Parliament would have "rubber stamped" any executive initiative.

Impact on Poor Minimal -- Cost to Military High

[1](#)5. (C) Across town at the Ministry of Planning, initial

results of the UK's DFID study on the impact of reducing the diesel subsidy in Yemen were released to donors and the ROYG on September 22. According to the study, the poorest twenty percent of the population would see only a four percent rise in prices. The DFID study cites price gouging by merchants as a more serious problem. Noting the negative effects on farmers who rely on diesel to power water pumps, the study also points out significant fears among the populace as to the consequences of ending the diesel subsidy. It quotes one participant in the study as saying if the diesel subsidy were eliminated, "I would die." (Note: Fifty percent of Yemenis are employed in the agricultural field). To counter this widespread misperception, the study recommends implementing an effective public awareness strategy on the true effects of the subsidy, as well as enhancing the social safety net.

16. (C) Beneath the surface of debate on the effects on the poor, is the reality that diesel smuggling in Yemen is big business. In arguing for the reform package, Deputy Prime Minister and Minister of Finance Salami said as much as 70 percent of diesel is smuggled out of the country and high oil prices have pushed the ROYG to spend 5 percent of its GDP (more than is spent on education or health care) to maintain the subsidy. Parliament is also actively discussing a nearly 1 billion USD budget supplement, largely to offset losses from the diesel subsidy.

17. (C) World Bank and Ministry of Finance sources all point to the military as the largest smuggler of diesel. Many suspect the dire predictions of senior officials of the negative consequences of ending the subsidy are overstated, and hold that the military's reliance on diesel smuggling is likely the real reason behind ROYG reluctance to push for this reform. (Comment: along with tribal support, loyalty of the armed forces has always been one of the mainstays of the Saleh regime. End Comment).

"The al-Houthi Cabinet Shuffle?"

18. (C) Rumors that a cabinet reshuffle is in the works continue, including rumors that Ba Jammal will be the first to go. Some newspapers point to three leading candidates to succeed the Prime Minister: Governor of Aden Shuaibi, Deputy Prime Minister Sofan, and rector of Sanaa University Salah Ba Sura. Ministry of Planning Senior Advisor Jalal Yaqoub referred to possible changes as the "al-Houthi cabinet shuffle." Insiders and observers alike point to corruption, daily blackouts in the city of Sanaa, and frustration over stagnant economic growth to be the issues fomenting a cabinet change. Prominent GPC leader and Shura council member Mohammed al-Tayyeb, however, told Pol/Econ Deputy he did not think a change in government is likely for at least six months, believing that Saleh would wait until this cabinet had served two years to make sweeping changes.

Comment

19. (C) While Parliament is slowly finding its democratic legs, it is unfortunate that it chose to flex its muscles by voting to reject an otherwise desirable economic reform package. The fault lies mainly in the ROYG's poor strategic economic planning. For seven years the ROYG has been grappling with the diesel subsidy, without making any serious attempt to "spin" the changes or investigate ways to mitigate the effects of doubling the price of diesel and gas. Three projects to build energy plants have languished in corrupt tendering processes for years which, had the ROYG moved forward on, could have eased small farmers' reliance on diesel. Parliament's protest vote rejecting economic reform demonstrates strong opposition to the status quo, particularly what is widely understood as pervasive government corruption; it did not offer an alternative package, nor does it currently possess the power to carry one through. Economic reform in Yemen will likely continue to stagnate until the President commits to follow through on vague promises to reduce corruption and focus on painful, long-term economic solutions. End comment.

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